

Helping Family Members During Tough Times – How Far Should You Go?

As the uncertain economy continues, many people might find friends and family members in troubled financial straits and in need of help. Unless you have plenty of money to spare, it's wise to seek a little advice before writing a check or offering your home or other property.

A financial expert such as a financial planning professional can help you sort out options based on different scenarios, but the important thing is to consider your financial needs first. If financial support is going to endanger your regular contributions to retirement or your child's education fund, you need to find non-financial means of help or severely limit the monetary commitment you make.

Here are some thoughts on handling such a situation:

Plan the talk first: Remember that this situation is as much about the relationship as about money. The decision to help a family member with money problems requires understanding – lecturing tends not to work so well. But it's right to encourage the people you want to help to look at their financial situation and if they are in debt trouble of any kind, they should get help. It's also important that you support them emotionally and have confidence that they will make it through this.

Consider whether you can make monetary support a gift: Actually, this is a good first question in any scenario where you offer help. What happens if you don't get the money back? For the sake of the relationship involved, it might make sense to think through that possibility. Would the potential loss of money injure you, and worse, will it injure the relationship? If you don't think you will be repaid would you be willing to consider it a gift?

Making your support a loan: There are good and bad aspects to private loans. The good news first: Terms can be significantly friendlier than what a borrower would qualify for in the open market. For example, the interest rate you charge on the loan can be lower than the borrower would pay a commercial lender. You can require little or no collateral. It's a way to keep money in the family. You may also choose to require little or no collateral, and you may want to extend the repayment period longer than a bank normally would offer. If you ask a lower interest rate, you need to understand that you are making a gift to the person of the amount of the "forgiven" interest. This amount should be deducted from the annual gift exclusion limit, which is \$12,000 for 2008.

Then the bad news: A poorly written agreement can lead to missed payments or default. For example, if the borrower dies suddenly, the lender's investment may be lost if the agreement isn't structured correctly. A properly executed promissory note is still an obligation of the estate, and may continue to be paid to an heir or other person or entity based on the terms as agreed. In addition, relatives cannot say they weren't treated fairly.

The best arrangements are formal – written in proper legal language, notarized and recorded in the county where the property resides. A financial planning professional can talk to both parties about what such loans – particularly real estate loans – can mean for their respective finances.

It also makes sense for both parties to visit their respective tax professionals to make sure they know the correct ways to document the loan transaction over time for tax purposes.

Are there nonfinancial solutions? There are other solutions besides writing a check. You may consider opening your home to family if they lose their housing or helping them maintain their home if they can't afford much beyond their mortgage and other bills. These are not small decisions and will lead to some financial sacrifice on your part – rising utility and food costs will increase your burden. You'll definitely want to revisit your household budget before you make this commitment.

Help them set a plan: No matter whether you offer a gift or a loan, you might want to work with them to develop a plan that will either return the money to you or put them back on their feet, or both. A financial planner can be a useful intermediary in this process.

Set an endpoint: The thing about blending unconditional love and money is that it can be tough for both parties to move on. It might be wise to set a particular endpoint for financial support at the beginning so both parties know the clock is ticking on a solution. If you're providing housing, loaning a car or providing some other non-financial support, it also makes sense to put an expiration date on that assistance so it doesn't become a permanent situation.

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Facing Tough Times? Know that Raiding Your Retirement Is Extremely Risky

The past year has been extremely tough on both investments and living costs for many people. But no matter how tough circumstances get, it's critically important to try and keep one's hands off their retirement funds.

Earlier this year, the Transamerica Center for Retirement Studies reported an increase in workers taking loans from their 401(k) and other work-based retirement savings. Eighteen percent of those surveyed reported they took loans from their retirement plans in 2007 compared to 11 percent in 2006. Yet keep in mind that while most plans provide an option for hardship withdrawal option for emergency medical or funeral expenses, the IRS restricts use of those funds for home purchases or tuition expenses.

There are serious financial consequences to breaking into 401(k) and other tax- advantaged retirement savings, and individuals tempted to do so should look for other alternatives.

Options are limited: There are such things as hardship loans, but the circumstances under which you can do so are limited. You can only use the money if you need to pay down medical expenses, avoid foreclosure on your primary home, pay college tuition, lose your job, become disabled or need to cover funeral expenses.

You'll generally pay penalties: You'll likely have to pay a 10 percent penalty if you take a distribution on retirement assets at 59.5 years of age or less. If you take a distribution from your employer-sponsored plan the employer is required to withhold 20 percent in tax penalties. In addition to those percentages, you'll also pay income taxes on the money you withdraw, which could mean that withdrawal may cost you anywhere from 30-40 percent that will go back to the government.

Even if you don't, there are still risks. In the case of withdrawals you make from an IRA you might take for your child or grandchild's education (as well as your own or your spouse's) can be taken out without the usual 10 percent penalty on early distributions before age 59 ½. But you really need to talk with a tax advisor or a personal finance expert like a financial planning professional to determine whether your IRA withdrawals will have to be reported on your Form 1040 and whether any tax headaches might ensue.

Be careful with loans: Generally, you have five years to pay back a loan on your 401(k) plan without having to pay a penalty or taxes. For a first home, you may be able to take as much as 15 years to pay it back, but the amounts can be limited. In most cases you can only withdraw up to 50 percent of the value of your 401(k) up to \$50,000. But what happens if you're fired or you quit? Nasty stuff – you'll have to pay back the entire amount that you borrowed within two or three months. If you can't do it, you'll owe taxes and a 10 percent penalty on what you took out.

Be extra careful with 401(k) debit cards: In the last year, companies have been offered the chance to link their employees to their money through a debit card. This was a very bad idea. Each transaction is a loan that must be paid back to the 401(k) account. If you default on the loan, you'll still face taxes and penalties. Read those rules very carefully, and better yet, just cut up the card.

Watch out for fees: Keep in mind that beyond the amount of investment gain you'll lose while that money is out of the account, your company sponsoring the 401(k) or the investment firm handling the IRA you owe might charge you heavy fee.

Be aware of outside consequences. You might hurt your kid's chances for financial aid in college. The entire withdrawal from an IRA -- whether taxable or not -- must be included as income on the following year's application for the Free Application for Federal Student Aid, or FAFSA. Family income does more to influence financial aid than the size of the family's assets, and dipping into your IRA can potentially damage your child's potential financial aid. Check with a trained financial planner expert in financial aid strategy before you make a move.

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Ring Out the Old Year with Some Tax-Saving Tips

Remember your retirement: If you and your spouse file jointly, by contributing to a traditional IRA each of you might be able to deduct up to \$5,000 if you're under 50 by the end of the year -- if you're older by yearend, that deduction rises to \$6,000. Keep in mind this deduction may be allowed (but may be limited) if you both were "active participants" in a retirement plan and your 2008 modified AGI is less than \$105,000 if married filing jointly or you are a qualifying widow or widower (or \$63,000 if single). If one of you is an active participant (check your W-2) and the other is not, then the one who is not active may still be allowed to make a deductible contribution if modified AGI is less than \$169,000. Contributions must be made prior to the required filing date for your return (April 15, 2009). Some employer qualified plans may also allow large employee deductions prior to year's end—if you can afford to make one, check with your plan administrator.

If you're still considering a hybrid automobile: Keep in mind there are still a few models left that offer tax credits, although the market-leading Toyota Prius is no longer one of them. [View a list](#). Also, the recent federal bailout plan approved \$1 billion in tax credits for purchasers of plug-in electric hybrid cars.

If you suffered disaster damage: The severe storms, tornadoes and hurricanes from spring through fall designated a surprisingly large number of counties around the nation as eligible for tax relief. To check if your community has been designated, go to the [IRS Web site](#).

Do an AMT checkup: If you're in a higher income bracket, before you start gathering deductions, it might be wise to talk with a tax adviser. Even though the recent federal bailout bill gave many taxpayers a break on the alternative minimum tax, it might make sense to see if you're actually covered. Before the passage of the bill, individual taxpayers got an exemption of \$33,750 and joint filers got a \$45,000 exemption; that will now increase to \$46,200 for individuals and \$69,950 for joint filers for 2008. The AMT is an alternative taxation system that's figured separately from your regular tax liability, and you have to pay whichever tax is higher. So, while it may make sense to pay estimated state taxes before year's end for purposes of the regular income tax, it may be better to postpone the payment if you are subject to AMT.

Check investment gains and losses: If you have some capital losses in your taxable investment accounts – a very likely prospect in 2008 – see if it makes sense to sell and offset them against any capital gains you've realized this year. Such losses can offset 100 percent of capital gains, plus up to another \$3,000 in ordinary income. Any losses in excess of that number can be carried forward to future tax years. Remember, mutual funds that may have faced large redemptions this year may throw off large capital gains even though your accounts may be showing losses. A financial planning professional can help you sort this out and make the most tax-efficient decision.

Prepay property taxes: If it makes sense to accelerate that deduction based on your tax advisor's opinion, pay those early 2009 taxes before the end of the year.

Prepay state taxes: Again, if it makes sense based on your tax situation, consider making a

fourth-quarter estimated state tax payment due in January this month to accelerate the deduction.

Defer income if possible: Self-employed people and some business owners might elect to invoice customers in January so they don't have to include that income on their 2007 return. Keep in mind that it may only make sense to defer income if you think you will be in the same or lower tax bracket next year.

Focus on energy: Also, the recent bailout bill extended the credit for residential solar property for eight through 2016, and removes the credit cap (currently \$2,000) for solar electric investments. The bill adds residential small wind investment, capped at \$4,000, and geothermal heat pumps, capped at \$2,000, as qualifying property. The bill allows the credit to be used to offset the AMT. And as usual, don't forget to deduct mileage for business purposes and keep in mind that there will be two deductible mileage rates in 2008 due to the aggressive mid-year increase in fuel costs. From January 1 to June 30, the rate is 50.5 cents a mile; from July 1 through December 31, the rate is 58.5 cents a mile.

Plan a stock donation to charity: If you have stock with a large unrealized capital gain that you've held longer than a year, you can give that stock to a qualified charity and claim a deduction for the current fair market value of the security. If you have a stock with an unrealized capital loss, do the opposite – sell the stock, claim the capital loss, then donate the resulting cash proceeds to charity. This is actually better than just donating cash, because you get the same deduction and never have to pay the capital gains taxes from the appreciated security, or you can take a current deduction if you have a loss. A similar donation to a donor-advised fund can provide the same current benefit while allowing you to take your time in appointing the specific charity to ultimately receive the gift.

Make sure donations are documented: You must have either a receipt or a canceled check to back up any contribution, regardless of the amount, and you can't simply give away junk and state a "like new" value for it. If you don't have such a written record, the IRS will reject the write-off if the lack of proper record keeping is discovered in an audit. Also, you can write off out-of-pocket costs you incur while doing good works. Ingredients for casseroles you regularly prepare for a nonprofit organization's soup kitchen, for example, or the cost of stamps you buy for your school's fundraiser count as a charitable contribution.

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